The Weekly

Economic & Market Recap

Peapack-Gladstone Bank, Private Wealth Management

October 6, 2017

As of 10/06/2017

STOCKS	Close	Wk Net Change	Wk % Change	Div Yield	YTD % Change	12 Mos % Change
DJIA	22,773.67	368.58	1.65	2.25	15.24	24.66
S&P 500	2,549.33	29.97	1.19	1.95	13.85	17.96
NASDAQ 100	6,064.57	85.27	1.43	1.09	24.69	24.43
S&P MidCap 400	1,818.43	22.49	1.25	1.56	9.51	17.76
Russell 2000	1,510.23	19.37	1.30	1.34	11.27	21.18

TREASURIES	Yield	FOREX	Price	Wk %Change
2-Year	1.51	Euro/Dollar	1.17	-0.68
5-Year	1.96	Dollar/Yen	112.65	0.12
10-Year	2.36	Sterling/Dollar	1.31	-2.46
30-Year	2.90	Dollar/Cad	1.25	0.49

Source: Thomson Reuters & Bloomberg

What Caught Our Eye This Week

Puerto Rico will run out of funds on October 31. The U.S. commonwealth's bankrupt government had $1.6 billion on hand before Hurricane Maria destroyed the island infrastructure. Puerto Rico was already in dire condition due to budget deficits, pension costs and a dwindling population. With more than 90% of residents still without electricity, the island has no economic activity and it will not be able to generate revenue for several months at least. Moody's estimates that Puerto Rico sustained $95 billion in hurricane-related damages. While the island waits for assistance from Congress, the attention has shifted to the $74 billion debt the Commonwealth owes. Puerto Rico's economy fell into recession in 2006 and has never recovered. The government resorted to heavy borrowing to balance its budget. In 2016, Congress enacted a law called Promesa that put Puerto Rico's finances under a federal oversight board. Earlier this year, Puerto Rico and its creditors entered a restructuring process known as Title III, a form of bankruptcy. The oversight board had approved a plan to pay bond holders about a quarter of what they are owed over the next decade, but now this plan is expected to be re-evaluated.

Economy

The most anticipated report this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls decreasing by 33,000 in September, which was below the consensus forecast of 90,000. This is the first payroll decline in seven years, and it is mostly because of recent hurricanes. The unemployment rate declined to 4.2% and the U-6 measure of unemployment decreased to 8.3%. Average hourly earnings increased by twelve cents and are now up 2.9% year-over-year. Examining the different employment sectors, healthcare added 23,000 jobs and construction added 8,000. Leisure and hospitality payrolls dropped by 111,000. The labor force participation rate increased to 63.1%, which is still low by historical standards. In other news this week, the ISM manufacturing survey surged to 60.8 in September, and the forward looking new orders index increased to 64.4. This ISM report showed 17/18 industries growing during the month. On Wednesday, the ISM non-manufacturing index increased to 59.8 which is the fastest pace since 2005. The new orders and business activity indexes both jumped above 60 (63 and 61.3). Finally, weekly jobless claims displayed a drop of 12,000 to 260,000 during the week ending September 30th.

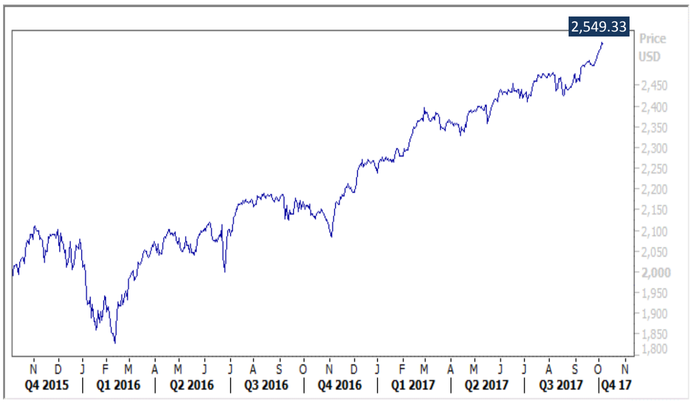
Fixed Income/Credit Market

With U.S. Treasury yields increasing across the entire curve anywhere from 4 basis points (bps) at the 1-month tenor to 23 bps at the 5-year tenor, fixed income performance for the month of September was negative for most sectors with the exception of senior loans and high yield bonds. Moreover, the high yield option adjusted spread started the month at over 400 bps and compressed an amazing 35 bps to close September at 370 bps. As a result, senior loans returned approximately 39 bps, while short duration high yield bonds returned roughly 28 bps. On the other hand, the selloff in treasuries globally caused non-currency hedged international treasuries to return negative 1.87% for the month. Other fixed income laggards included long and intermediate term domestic government bonds which returned negative 0.84% and 0.89%, respectively. It will be interesting to see if Mario Draghi officially announces the ECB's pace of asset purchases for 2018 later this month.

Equities

Third quarter earnings season kicked off this week as 23 companies in the S&P 500 reported. With less than 5% of large cap companies reporting, the sample size is not large enough to draw significant conclusions regarding earnings for the overall market, but generally solid earnings reports helped lift equity markets. Better than expected economic reports, particularly for manufacturing, auto sales and ISM services, signaled continued economic expansion and were also supportive of higher equity prices. This week's leading sector was materials, advancing 1.95%. Financials were also strong, increasing 1.85% as interest rates continue to climb. The worst performing sector this week was energy, declining 0.61% with crude oil (WTI) falling 4.53% and closing at $49.33. The S&P 500 Index set record highs for six consecutive days until Friday's decline, which was last accomplished 20 years ago. In 2017, the S&P 500 index has set 43 new highs advancing approximately 13.85% this year.

S&P 500



Our View

We have frequently discussed equity market valuations that appear extended by most metrics. Valuations can remain uncomfortably elevated for extended periods of time. Waiting for the inevitable inflection point when valuations correct, either by stock prices falling or earnings rising, can be lengthy and very costly from missed investment opportunities. We indeed seem overdue for an equity market correction, but the conditions for a bear market are not evident. The economy continues to grow without significant excesses, and global central banks remain accommodative. There is less discussion in the business press of bond market valuations which seem high as well. Recently, former Fed Chair Alan Greenspan said, "the bubble is in bonds, not stocks." Interest rates remain very low considering the domestic economy is operating with an unemployment rate of 4.2%, and we are many years from the crisis that caused the need for quantitative easing. With negative yields abroad and inflation expectations anchored below the Fed's 2.0% inflation target, demand for treasuries remains strong. We do not anticipate a meaningful valuation adjustment for either fixed income or equity markets until higher inflation systematically manifests itself.

COMING UP NEXT WEEK		Est.
10/12 PPI Final Demand MM	(Sep)	0.4%
10/12 Core PPI MM, SA	(Sep)	0.2%
10/13 CPI MM, SA	(Sep)	0.6%
10/13 Retail Sales Ex-Autos MM	(Sep)	0.3%
10/13 Retail Sales MM	(Sep)	1.7%
10/13 Retail Control	(Sep)	0.4%
10/13 U Mich Sentiment Prelim	(Oct)	95.4

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